

PHILIP MORRIS COMPANIES INC. INTER-OFFICE CORRESPONDENCE

120 PARK AVENUE, NEW YORK 10017

TO: Michael A. Miles

DATE: April 21, 1993

FROM: Dede Thompson Bartlett

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SUBJECT: 10 Most Difficult Annual Meeting Questions

MICHAEL A. MILES

The following are ten of the most difficult questions that could arise at the Annual Meeting. They are also representative of the concerns that shareholders are expressing in letters and comments on proxy cards.

1. You took too long to act decisively when you saw discount cigarettes growing and eating into Marlboro's profits. Why should we think you've got a good handle on the problem now, when you misread the signals for so long?

Answer:

- We would have been irresponsible if we had moved too early, just as we would be irresponsible if we had waited too long.
- Marlboro, our core franchise, really wasn't affected until last summer. In the fall, we took steps to reduce the price differential between discount and premium brands.
- Early this year, we realized the strategy was not working. The economy was not improving, and using our 1992 strategy wasn't going to be effective enough.
- At the same time, we were confirming in tests that we did not have a franchise problem and that Marlboro could still grow when priced competitively. That led us to today.
- So, we believe we weren't too early, and we know we're not too late. This is the time.
- We have had proven experience in managing this kind of strategy, and we believe we will be successful with this new Marlboro strategy.

2. I am not fond of surprises. We read your press release of January 7th in which you said you were encouraged by market trends. Your analyst presentations late in January supported that position. The March annual report gave a glowing summary of the business. Then you dropped a bomb on April 2. How could this happen?

*Not move precipitously
Not until
end of March
that saw clearly
tactics weren't
working*

*moved promptly
in light of info
available*

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Answer:

- The January 7th release and our presentations to the analysts were cautiously optimistic: trends in the market place at that time suggested that there would be increases in profitability and slow growth in the discount product. In a short period of time, each of these trends went sour.
- The Annual Report, which you received in late March, was prepared in mid-February and went to press in early March. This was at or about the time when we discovered that the price gap between premium and discount price cigarettes had widened rather than narrowed.
- Believing that we could remedy the situation, we raised the price of discount brands. We were wrong, but took this action still believing that the trends we discussed were sustainable in the market place.
- Our April 2nd price promotion action resulted from our recognition that premium pricing had to be corrected.

3. Will you reduce executive salaries and bonuses in light of the reduced profitability of the company as a result of Marlboro Friday?

Answer:

- I do not know since the compensation of our most senior executives is set by the Compensation Committee of the Board.
- The Committee will continue to review that compensation in 1993.
- Compensation in our company has always been based on performance. We expect that this will continue.
- The Committee could decide that compensation and/or bonuses will be affected by performance measured against these new strategies.

4. Why don't you just admit that the link between smoking and lung cancer is very strong? Why does our company keep denying what everyone else knows to be true?

Answer:

- We acknowledge that smoking is a risk factor for certain human diseases and we agree that consumers should be aware of these alleged risks.
- We believe consumers already are aware. Warning labels have been on cigarette packs for more than 25 years.

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- The issue of whether the industry fraudulently misled the public as to the health effects of cigarette smoking was tried to juries in both Cipollone and Kueper and in both cases, the juries unanimously found no fraudulent misrepresentation on the part of the defendants.

5. Are you increasing your purchases of company stock now that it is such a good buy?

Answer:

- Through March 31, 1993, we purchased 11.7 million shares for \$854 million.
- While we have remaining authority to purchase (\$800 million) additional shares in 1993, our first priority is to maintain a strong financial position, which includes the funding of some \$2.8 billion of previously announced acquisitions. That lowers the priority for share repurchases in 1993.

6. How much would unit sales of cigarettes be reduced with a \$1.00 increase in the Federal Excise Tax? A \$2.00 increase?

Answer: To be developed.

7. Since January, our Company has lost \$13 billion in value and has projected a \$2 billion reduction in earning in 1993. What value do your shareholders get for your April 2 decisions and when do we get to see the benefit?

Answer:

- This has been one of the most volatile periods in history for our company and our shareholders. We recognize that, in large measure, our decisions have caused this volatility.
- However, we believe that in the longer term, these very difficult decisions will result in a far stronger tobacco business.
- We believe that the price gaps between premium brands and discounted cigarettes jeopardized the business. Our April 2nd action will reduce the gaps and will result, we believe, in a vital growing business.

8. Why did the Company deliberately misrepresent itself to the shareholders by concealing the 1992 trade imbalances? And what are our present loading practices?

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Answer:

- We have never concealed trade imbalances.
- Inventory management in the tobacco industry is very complex and a discussion could take hours.
- Suffice to say that any trade imbalances which may have existed resulted from reasonable sales assumptions which proved later to be incorrect. Both we and the trade made many of the same assumptions.
- Any remaining trade imbalances are being rectified.
- Our returns have been minimal, which proves that the vast majority of the sales assumptions we made were correct.

9. What percentage of your assets is held in Company stock?

Answer:

- I have purchased (amount of stock) and I have a substantial interest in this company. It is a significant portion of my assets.

10. Given the growing concerns about the U.S. tobacco business - the potential increase in taxes, growing discount segment, litigation and increased anti-smoking activism - will the Company shift its focus to markets overseas? Can the Company compensate in volume for the lower average profit per pack sold abroad?

Answer:

- As to shifting focus, the answer is no. We believe that, with the appropriate strategies, there is room for substantial growth in the U.S. although we also recognize that our growth potential overseas is quite attractive, as well, particularly since Marlboro is the most highly recognized, successful and profitable consumer brand in the world.
- (Awaiting answer to last part of question regarding lower average profit per pack).

cc: Murray H. Bring

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